

Executive Summary*

At its peak, American International Group (AIG) was one of the largest and most successful companies in the world, boasting a AAA credit rating, over \$1 trillion in assets, and 76 million customers in more than 130 countries. Yet the sophistication of AIG's operations was not matched by an equally sophisticated risk-management structure. This poor management structure, combined with a lack of regulatory oversight, led AIG to accumulate staggering amounts of risk, especially in its Financial Products subsidiary, AIG Financial Products (AIGFP). Among its other operations, AIGFP sold credit default swaps (CDSs), instruments that would pay off if certain financial securities, particularly those made up of subprime mortgages, defaulted. So long as the mortgage market remained sound and AIG's credit rating remained stellar, these instruments did not threaten the company's financial stability.

The financial crisis, however, fundamentally changed the equation on Wall Street. As subprime mortgages began to default, the complex securities based on those loans threatened to topple both AIG and other long-established institutions. During the summer of 2008, AIG faced increasing demands from their CDS customers for cash security – known as collateral calls – totaling tens of billions of dollars. These costs put AIG's credit rating under pressure, which in turn led to even greater collateral calls, creating even greater pressure on AIG's credit.

By early September, the problems at AIG had reached a crisis point. A sinkhole had opened up beneath the firm, and it lacked the liquidity to meet collateral demands from its customers. In only a matter of months AIG's worldwide empire had collapsed, brought down by the company's insatiable appetite for risk and blindness to its own liabilities.

AIG sought more capital in a desperate attempt to avoid bankruptcy. When the company could not arrange its own funding, Federal Reserve Bank of New York President Timothy Geithner, who is now Secretary of the Treasury, told AIG that the government would attempt to orchestrate a privately funded solution in coordination with JPMorgan Chase and Goldman Sachs. A day later, on September 16, 2008, FRBNY abandoned its effort at a private solution and rescued AIG with an \$85 billion, taxpayer-backed Revolving Credit Facility (RCF). These funds would later be supplemented by \$49.1 billion from Treasury under the Troubled Asset Relief Program (TARP), as well as an additional \$133.3 billion from the Federal Reserve. The total government assistance reached \$182 billion.

After reviewing the federal government's actions leading up to the AIG rescue, the Panel has identified several major concerns:

*The Panel adopted this report with a 4-0 vote on June 9, 2010.

The government failed to exhaust all options before committing \$85 billion in taxpayer funds. In previous rescue efforts, the federal government had placed a high priority on avoiding direct taxpayer liability for the rescue of private businesses. For example, in 1998, the Federal Reserve pressed private parties to prevent the collapse of Long-Term Capital Management, but no government money was used. In the spring of 2008, the Federal Reserve arranged for the sale of Bear Stearns to JPMorgan Chase. Although the sale was backed by \$28.2 billion of federal loans, much of the risk was borne by private parties.

With AIG, the Federal Reserve and Treasury broke new ground. They put U.S. taxpayers on the line for the full cost and the full risk of rescuing a failing company.

During the Panel's meetings, the Federal Reserve and Treasury repeatedly stated that they faced a "binary choice": either allow AIG to fail or rescue the entire institution, including payment in full to all of its business partners. The government argues that AIG's failure would have resulted in chaos, so that a wholesale rescue was the only viable choice. The Panel rejects this all-or-nothing reasoning. The government had additional options at its disposal leading into the crisis, although those options narrowed sharply in the final hours before it committed \$85 billion in taxpayer dollars.

For example, the federal government could have acted earlier and more aggressively to secure a private rescue of AIG. Government officials, fully aware that both Lehman Brothers and AIG were on the verge of collapse, prioritized crafting a rescue for Lehman while they left AIG to attempt to arrange its own funding. By the time the Federal Reserve Bank reversed that approach, leaving Lehman to collapse into bankruptcy without help and concluding that AIG posed a greater threat to financial stability, time to explore other options was short. The government then put the efforts to organize a private AIG rescue in the hands of only two banks, JPMorgan Chase and Goldman Sachs, institutions that had severe conflicts of interest as they would have been among the largest beneficiaries of a taxpayer rescue.

When that effort failed, the Federal Reserve decided not to press major lenders to participate in a private deal or to propose a rescue that combined public and private funds. As Secretary Geithner later explained to the Panel it would have been irresponsible and inappropriate in his view for a central banker to press private parties to participate in deals to which the parties were not otherwise attracted. Nor did the government offer to extend credit to AIG only on the condition that AIG negotiate discounts with its financial counterparties. Secretary Geithner later testified that he believed that payment in full to all AIG counterparties was necessary to stop a panic. In short, the government chose not to exercise its substantial negotiating leverage to protect taxpayers or to maintain basic market discipline.

There is no doubt that orchestrating a private rescue in whole or in part would have been a difficult – perhaps impossible – task, and the effort might have met great resistance from other

financial institutions that would have been called on to participate. But if the effort had succeeded, the impact on market confidence would have been extraordinary, and the savings to taxpayers would have been immense. Asking for shared sacrifice among AIG's counterparties might also have provoked substantial opposition from Wall Street. Nonetheless, more aggressive efforts to protect taxpayers and to maintain market discipline, even if such efforts had failed, might have increased the government's credibility and persuaded the public that the extraordinary actions that followed were undertaken to protect them.

The rescue of AIG distorted the marketplace by transforming highly risky derivative bets into fully guaranteed payment obligations. In the ordinary course of business, the costs of AIG's inability to meet its derivative obligations would have been borne entirely by AIG's shareholders and creditors under the well-established rules of bankruptcy. But rather than sharing the pain among AIG's creditors – an outcome that would have maintained the market discipline associated with credit risks – the government instead shifted those costs in full onto taxpayers out of a belief that demanding sacrifice from creditors would have destabilized the markets. The result was that the government backed up the entire derivatives market, as if these trades deserved the same taxpayer backstop as savings deposits and checking accounts.

One consequence of this approach was that every counterparty received exactly the same deal: a complete rescue at taxpayer expense. Among the beneficiaries of this rescue were parties whom taxpayers might have been willing to support, such as pension funds for retired workers and individual insurance policy holders. But the across-the-board rescue also benefitted far less sympathetic players, such as sophisticated investors who had profited handsomely from playing a risky game and who had no reason to expect that they would be paid in full in the event of AIG's failure. Other beneficiaries included foreign banks that were dependent on contracts with AIG to maintain required regulatory capital reserves. Some of those same banks were also counterparties to other AIG CDSs.

Throughout its rescue of AIG, the government failed to address perceived conflicts of interest. People from the same small group of law firms, investment banks, and regulators appeared in the AIG saga in many roles, sometimes representing conflicting interests. The lawyers who represented banks trying to put together a rescue package for AIG became the lawyers to the Federal Reserve, shifting sides within a matter of minutes. Those same banks appeared first as advisors, then potential rescuers, then as counterparties to several different kinds of agreements with AIG, and ultimately as the direct and indirect beneficiaries of the government rescue. The composition of this tightly intertwined group meant that everyone involved in AIG's rescue had the perspective of either a banker or a banking regulator. These entanglements created the perception that the government was quietly helping banking insiders at the expense of accountability and transparency.

Even at this late stage, it remains unclear whether taxpayers will ever be repaid in full. AIG and Treasury have provided optimistic assessments of AIG's value. As current AIG CEO Robert Benmosche told the Panel, "I'm confident you'll get your money, plus a profit." The Congressional Budget Office (CBO), however, currently estimates that taxpayers will lose \$36 billion. A large portion of the funds needed to repay taxpayers will be generated through the sale of assets bought by the government to assist AIG, assets still held by AIG, and units of AIG sold to third parties or to the public through initial public offerings. The uncertainty lies in whether AIG's remaining business units will generate sufficient new business to create the necessary shareholder value to repay taxpayers in full. AIG's management is unsurprisingly bullish on that prospect, where the CBO does not attempt to forecast such expansion in revenues and instead relies on a baseline estimate. For now, the ultimate cost or profit to taxpayers is unknowable, but it is clear that taxpayers remain at risk for severe losses.

The government's actions in rescuing AIG continue to have a poisonous effect on the marketplace. By providing a complete rescue that called for no shared sacrifice among AIG's creditors, the Federal Reserve and Treasury fundamentally changed the relationship between the government and the country's most sophisticated financial players. Today, AIG enjoys a five-level improvement in its credit rating based solely on its access to government funding on generous terms. Even more significantly, markets have interpreted the government's willingness to rescue AIG as a sign of a broader implicit guarantee of "too big to fail" firms. That is, the AIG rescue demonstrated that Treasury and the Federal Reserve would commit taxpayers to pay any price and bear any burden to prevent the collapse of America's largest financial institutions, and to assure repayment to the creditors doing business with them. So long as this remains the case, the worst effects of AIG's rescue on the marketplace will linger.

In this report, the Panel presents a comprehensive overview of the AIG transactions based on a review of many thousands of documents. In addition to reviewing the likelihood of repayment from AIG, the Panel focuses on the decisions by the Federal Reserve and Treasury to rescue AIG and the ways they executed that rescue. Their decisions set the course for the AIG rescue and the broader TARP and raise significant policy questions that the Federal Reserve and Treasury may face again – questions that are best answered in careful consideration of the aftermath of AIG's rescue rather than in the throes of the next crisis.

Through a series of actions, including the rescue of AIG, the government succeeded in averting a financial collapse, and nothing in this report takes away from that accomplishment. But this victory came at an enormous cost. Billions of taxpayer dollars were put at risk, a marketplace was forever changed, and the confidence of the American people was badly shaken. How the government will manage those costs, both in the specific case of AIG and in the more general case of TARP, remains a central challenge – one the Panel will continue to review.

Figure 1: Overview of the AIG Transactions

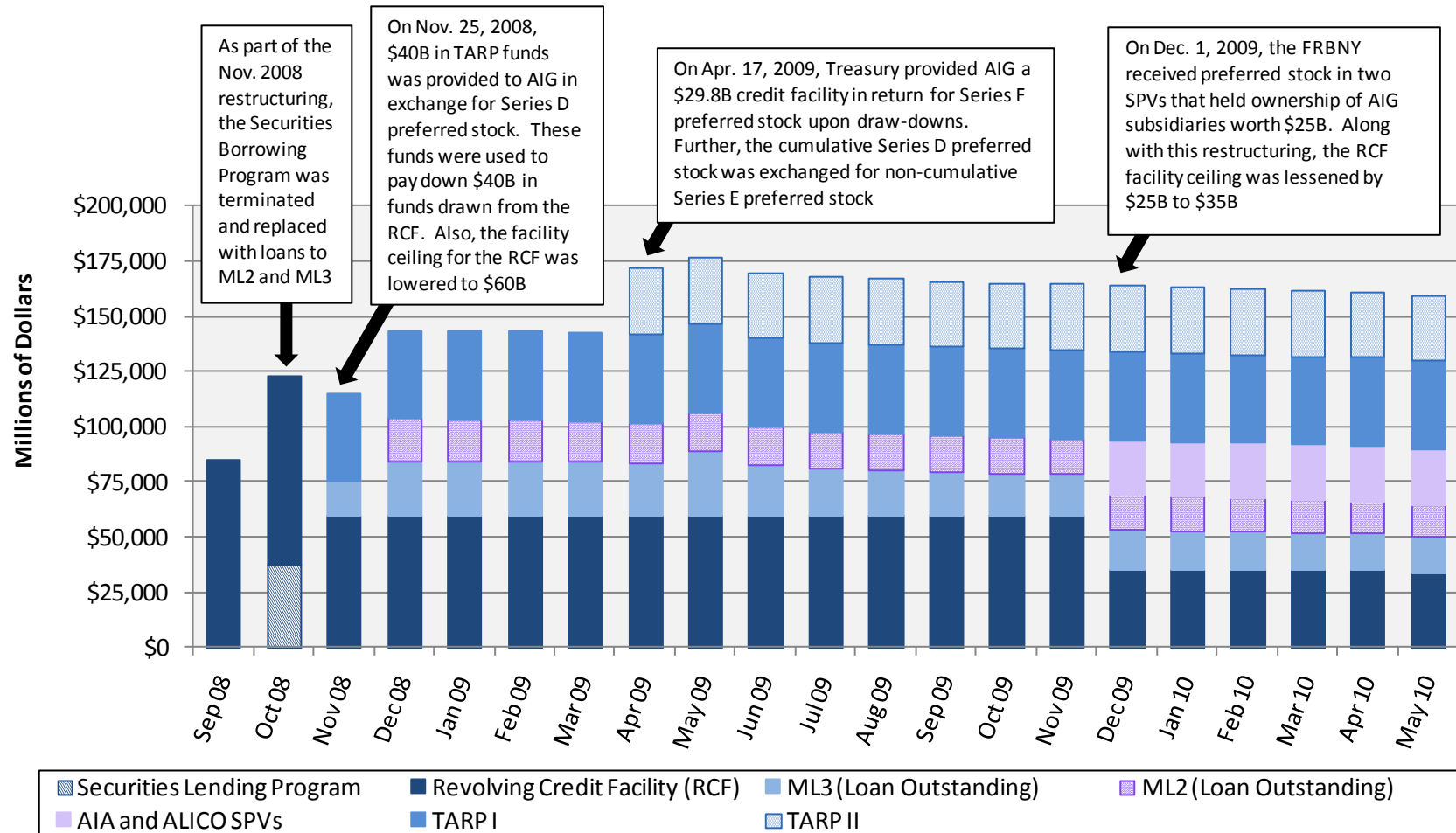
The government's rescue of AIG involves several different funding facilities provided by different government entities, with various changes to the transactions over time. The following tables summarize the sources of funds for AIG's rescue and the current status of that assistance, as well as the uses to which those funds were put. The report discusses these transactions in more detail.

Trans- action Date	Type of Transaction/ Security	Length of Loan/ Term of Invest- ment	Capital/ Available Credit to AIG or ML Entity	Interest Rate	Oversight	Changes to Previous Transactions	Status Over Time: Exposure at Height; Total Current Exposure
Federal Reserve Revolving Credit Facility							
9/16/2008	FRBNY received Series C Perpetual, Convertible, Participating Preferred Stock convertible into 79.9% of issued and outstanding common shares	2 years	Up to \$85B	3-month LIBOR + 8.5% on drawn funds; 8.5% fee on undrawn but available funds; one-time commitment fee of 2% of loan principal	3 independent trustees to oversee equity interest for duration of loan	N/A	Exposure at height of facility: \$72B (10/2008) Total current exposure: \$26.1B outstanding as of 5/27/2010
11/25/2008	Reduction in loan ceiling and interest rate	Extended to 5 years	Reduced to \$60B	3-month LIBOR (with a minimum floor of 3.5%) + 3% on drawn funds; 0.75% fee on undrawn funds		Loan term extended; credit available reduced; interest rate reduced; fee on undrawn funds reduced by 7.75% points to 0.75%	
4/17/2009	Reduction in interest rate			3-month LIBOR (no floor) + 3% on drawn funds; 0.75% fee on undrawn funds		Removed minimum 3.5% LIBOR borrowing floor; permitted issuance of preferred stock to Treasury	
12/1/2009	Debt for equity swap		Reduced to \$35B			Reduced loan ceiling by \$25B in exchange for FRBNY obtaining a preferred interest in AIA and ALICO SPVs	
5/6/2010	Reduction in loan ceiling		Reduced to \$34B			Reduced loan ceiling due to sale of HighStar Port Partners, L.P.	

Federal Reserve Securities Borrowing Facility							
10/8/2008	FRBNY borrowed investment-grade, fixed income securities from AIG in exchange for cash collateral		Up to \$37.8B			Facility creates better terms for AIG, as the company is effectively the lender of securities for cash	Exposure at height of facility: \$17.5B (10/2008) Total current exposure: None; became Maiden Lane II
TARP-SSFI/AIGIP							
11/25/2008	Treasury purchased Series D Fixed Rate Cumulative Preferred and Warrants for common stock	Perpetual Life (Preferred); 10-year life (Warrants)	\$40.0B	10% quarterly dividends, cumulative	Treasury	Capital used to pay down original Fed credit facility; Trust ownership percentage on conversion becomes 77.9%, with Treasury holding warrants equal to an additional 2% common stock ownership	Total current exposure is highest to date. Treasury holds: – \$40B in Series E Fixed Rate Non-Cumulative Preferred Stock – \$7.5B in Series F Fixed Rate Non-Cumulative Perpetual Preferred Stock – Warrants equal to 2% of common shares outstanding
4/17/2009	Treasury exchanged Series D for Series E Fixed Rate Non-Cumulative Preferred Shares and Warrants for common stock	Perpetual Life		10% quarterly dividends, non-cumulative	Treasury	Treasury exchanged Series D Preferred Shares for Series E Fixed Rate Non-Cumulative Preferred Shares. Accrued and unpaid dividends of \$1.6B from Series D shares must be paid at time of Series E redemption	Accrued and unpaid dividends from original Series D Preferred Stock of \$1.6B outstanding must be paid at redemption. Additional \$0.2B commitment fee to be paid from AIG's operating income in three equal installments over 5-year life of revolving credit facility
4/17/2009	Treasury purchased additional Series F Fixed Rate Non-Cumulative Preferred Shares and Warrants for common stock	Perpetual Life (Preferred); 10-year life (Warrants)	\$29.8B	10% quarterly dividends, non-cumulative	Treasury	Additional capital injection that reflects a commitment of up to \$30.0B reduced by \$0.2B in retention payments made by AIGFP to employees in March 2009	

Maiden Lane II							
11/10/2008	FRBNY formed LLC to purchase RMBS from AIG insurance subsidiaries, lending money to the LLC for this purpose	6 years, to be extended at FRBNY's discretion	Up to \$22.5B	1-month LIBOR + 100 bps (loan by FRBNY); 1-month LIBOR + 300 bps (deferred purchase price to AIG subs)	FRBNY with asset management by BlackRock Financial Management	Terminates Securities Borrowing Facility. Formation of an LLC to be lent money from FRBNY to purchase RMBS from AIG insurance subsidiaries. AIG sub receives a 1/6 participation in any residual portfolio cash flows after loan repayment. FRBNY receives 5/6 of any residual cash flows	Principal balance exposure at closing (height): \$19.5B on Fed senior loan Total current exposure on outstanding principal amount and accrued interest due to FRBNY: \$14.9B as of 5/27/2010, with deferred payment and accrued interest due to AIG subsidiaries of \$1.1B as of 5/27/2010
Maiden Lane III							
11/10/2008	FRBNY formed LLC to purchase multi-sector CDOs from counterparties of AIGFP, lending money to the LLC for this purpose	6 years, to be extended at FRBNY's discretion	Up to \$30.0B	1-month LIBOR + 100 bps (loan by FRBNY); 1-month LIBOR + 300 bps (repayment to AIG of equity contribution amount)	FRBNY with asset management by BlackRock Financial Management	Same as above, only for purchase of multi-sector CDOs from counterparties of AIGFP. AIG and FRBNY receive 33% and 67%, respectively, of any remaining proceeds after repayment of loan and equity contribution	Principal balance exposure at closing (height): \$24.3B on Fed senior loan Total current exposure on outstanding principal amount and accrued interest due to FRBNY: \$16.6B as of 5/27/2010, with outstanding principal and accrued interest on loan due to AIG of \$5.3B as of 5/27/2010

Figure 2: Maximum Government Exposure to AIG Rescue¹



¹ For ML2 and ML3, the FRBNY loan amount outstanding with respect to a given month is used instead of the original full value of the facility in order to more accurately reflect the funds at risk.

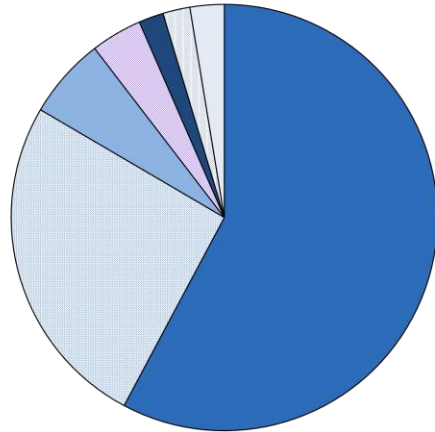
Figure 3: Government Assistance to AIG as of May 27, 2010² (millions of dollars)

	Amount Authorized	Assistance Amount Outstanding as of 5/27/10
FRBNY		
Revolving Credit Facility	\$34,000	\$26,133
Maiden Lane II: Outstanding principal amount of loan extended by FRBNY	22,500	14,532
Net portfolio holdings of Maiden Lane II LLC	—	15,910
Accrued interest payable to FRBNY	—	342
Maiden Lane III: Outstanding principal amount of loan extended by FRBNY	30,000	16,206
Net portfolio holdings of Maiden Lane III LLC ³	—	23,380
Accrued interest payable to FRBNY	—	427
Preferred interest in AIA Aurora LLC	16,000	16,266
Accrued dividends on preferred interests in AIA Aurora LLC		125
Preferred interest in ALICO SPV	9,000	9,150
Accrued dividends on preferred interests in ALICO Holdings LLC	—	70
Total FRBNY	111,500	83,251
TARP		
Series E Non-cumulative Preferred stock	40,000	40,000
Unpaid dividends on Series D Preferred stock		1,600
Series F Non-cumulative Preferred stock	29,835	7,544
Total TARP	69,835	49,144
Net borrowings	181,335	129,831
Accrued interest payable and unpaid dividends		2,564
Total Balance Outstanding	\$181,335	\$132,395

² U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending May 26, 2010*, at 18 (May 28, 2010) (online at www.financialstability.gov/docs/transaction-reports/5-28-10%20Transactions%20Report%20as%20of%205-26-10.pdf) (hereinafter “Treasury Transactions Report”); Board of Governors of the Federal Reserve System, *Factors Affecting Reserve Balances (H.4.1)* (May 27, 2010) (online at www.federalreserve.gov/releases/h41/20100527/) (hereinafter “Federal Reserve H.4.1 Statistical Release”).

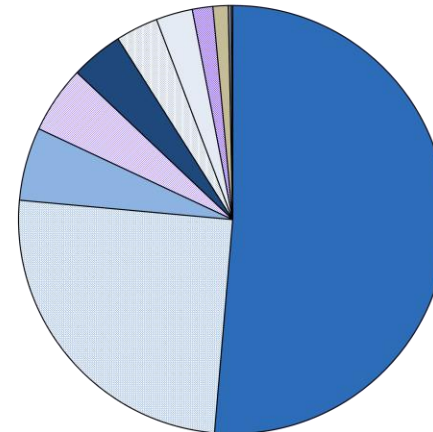
³ Federal Reserve H.4.1 Statistical Release, *supra* note 2 (“Dividends accrue as a percentage of the FRBNY’s preferred interests in AIA Aurora LLC and ALICO Holdings LLC. On a quarterly basis, the accrued dividends are capitalized and added to the FRBNY’s preferred interests in AIA Aurora LLC and ALICO Holdings LLC.”).

Figure 4: AIG Use of Government Assistance in 2008 and 2009* (millions of dollars)



2008

- Loans to AIGFP for collateral postings, GIA and other debt maturities: \$46,997
- Capital contributions and loans to insurance companies: \$20,850
- Funding of equity interest in ML3: \$5,000
- Repayment of obligations to securities lending program: \$3,160
- Repayment of intercompany loans: \$1,528
- Contributions to AIGCFG subsidiaries: \$1,672
- Debt payments: \$2,109



2009

- Loans to AIGFP for collateral postings, GIA and other debt maturities: \$50,605
- Capital contributions and loans to insurance companies: \$24,718
- Debt payments: \$5,448
- Funding of equity interest in ML3: \$5,000
- Loans to ILFC: \$3,900
- Repayment of obligations to securities lending program: \$3,160
- Intercompany purchase of ILFC equity ownership: \$2,722
- Repayment of intercompany loans: \$1,528
- UGC related restructuring transactions: \$1,132
- Contributions to AIGCFG subsidiaries: \$222
- Temporary paydown of FRBNY Credit Facility: \$101

*American International Group, Inc., *Form 10-K for the Fiscal Year Ended December 31, 2009*, at 44-45 (Feb. 26, 2010) (online at www.sec.gov/Archives/edgar/data/5272/000104746910001465/a2196553z10-k.htm).